[2022] UKUT 00196 (TCC)

Appeal number:
UT/2021/000161

INCOME TAX AND NATIONAL INSURANCE CONTRIBUTIONS — payment to employees – pension scheme changed – whether "from" the employment – appeal allowed

UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)

E. ON UK PLC **Appellant**

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS **Respondents**

TRIBUNAL: MR JUSTICE ADAM JOHNSON
JUDGE SWAMI RAGHAVAN

Sitting in public at the Rolls Building in London, on 23 and 24 March 2022
Jolyon Maugham QC and Georgia Hicks, counsel, for the Appellant

Charles Bradley, counsel, instructed by the General Counsel and Solicitor to HM Revenue & Customs, for the Respondents

DECISION

Introduction

1. E.ON UK Plc ("E.ON"), the well-known energy supplier, made a one-off payment ("Facilitation Payment") to employees who were members of its defined benefit pension scheme. The issue before the First-tier Tribunal ("FTT") was whether the payment, in relation to a particular employee and pension scheme member, Mr Brotherhood, and which in his case amounted to £3,791, was subject to employment earnings taxation and National Insurance Contributions ("NICS") on the basis it was "from" his employment for the purposes of the relevant tax and NICS legislation. HMRC argued it was, whereas E.ON argued the payment was to compensate for adverse changes made to his pension arrangements. The FTT agreed with HMRC. E.ON appeals against the FTT's decision published as *E.ON UK PLC v HM Revenue and Customs* [2021] UKFTT 156 (TC) ("the FTT Decision") with the permission of the FTT on three grounds of appeal, and the Upper Tribunal's permission on a further ground of appeal.

Law

2. The legal requirement, that a sum is "from" employment for the purposes of taxing it as employment income, is found in s9(2) Income Tax (Earnings and Pensions) Act 2003 ("ITEPA 2003"), which charges earnings "from an employment…". There is no issue that despite the different terms of the NICs legislation, a similar requirement for NICs purposes is found in s3(1) Social Security Contributions and Benefits Act 1992. That legislation includes, within the definition of earnings subject to NICs, "any remuneration or profit derived from an employment". The full text of the provisions is set out at [89] to [91] of the FTT Decision. As nothing in this appeal turns on the statutory setting of the "from an employment" requirement we need not set those provisions out again.

3. Many case-law authorities have considered the interpretation of the above requirement, or its equivalent in earlier legislation. The principles to be drawn from some of these authorities are disputed. We cover these when discussing the grounds of appeal.

Background FTT Decision

4. The FTT set out detailed findings of fact in relation to the various different pension schemes E.ON operated and which the FTT considered relevant to the appeal, the contents and chronology of the package the employee's union negotiated with E.ON, which included the Facilitation Payment in issue, and the way in in which package was then implemented. No challenge is made to these underlying facts. We mention here the background facts sufficient to understand the issues in the appeal before us.

5. E.ON ran various different types of pension scheme: a Defined Benefit scheme of which there were two categories: 1) a "Retirement Balance" category – Mr Brotherhood was in this category and 2) a "Final Salary" category. It also ran a Defined Contribution scheme.

6. E.ON's management wanted to reduce the costs associated with the Defined Benefit scheme. It proposed changes to the scheme which are detailed below. Part of the integrated package deal that was negotiated with the unions included a payment described as a "Facilitation Payment". This was calculated as 7.5% of salary (after application of the 2018 pay award which was part of the package) subject to a minimum of £1000. The Facilitation Payments, totalling around £6.48 million, were made by E.ON to the 2,238 Retirement Balance and Final Salary employees in the November 2018 payroll.

7. In addition to the pension changes and Facilitation Payment, the other elements of the package were a two year pay deal (increases of 3.5% for year beginning 1 April 2018 and 3% for year beginning 1 April 2019), a commitment by E.ON not to make any further pension changes for five years, and a set of "employer commitments" by E.ON (for instance to employ the majority of the permanent workforce directly and regarding the extent of outsourcing). The two year pay deal was only available to those who accepted the offer.

8. Before the changes, the Retirement Balance category worked as follows:

> (1) *Benefit levels* - A member selected one of five benefit levels, which they could change in April each year: 20%, 25%, 30%, 35% and 40%. The percentage corresponded to the percentage of pensionable pay in that year that was credited as a notional sum to their retirement balance account. So, if for example, as Mr Brotherhood did, 40% was selected, 40% of his pensionable pay was credited.
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> (2) *Benefits on retirement* - On retirement the member could access the total Retirement Balance, which had been adjusted year on year for inflation in line with RPI, to take a cash lump sum or buy an annual pension.
>
> (3) *Funding* - The provision of Retirement Balance was part employee funded and part employer funded. As regards the employee, pension contributions were deducted from the employee's gross pay at source. The contributions increased every year to reflect the employee's age. As regards employer funding, E.ON paid such contributions as determined necessary by the scheme actuary and underwrote the investment risk.
>
> (4) *Option to top up beyond 40%* - Members who had selected the 40% level could buy additional benefit levels in multiples of 5% up to 100%. Each 5% increment would require a further contribution from the

employee. E.ON would fund the balance through its contribution and underwriting of investment risk. Mr Brotherhood did not take up this option. At the time the changes were implemented the option was taken up by 75 members (which was 7% of the total 1,100 Retirement Balance category members).

9. The changes to the Retirement Balance scheme were:

(1) The member contributions for each benefit level increased, apart from the 20% level. The level of increase went up by 1% for each benefit level. The contributions increases ranged from 1% for the 25% level to 4% for the 40% level.

(2) The option to top up above 40% was removed.

10. The impact of the changes on Mr Brotherhood's particular circumstances was set out in an individualised statement as follows:

> "Based on your pensionable pay of £47,916 and core benefit level of 40%:
>
> We would credit £19,166 to your retirement balance for the year. You currently pay 8.4% of your pensionable pay towards this: £ 4,025 each year.
>
> Under the current benefit structure, contributions increase as you age (up to age 64), and next year contributions would have been 8.7% of your pensionable pay: £4,169 each year.
>
> Under the proposals, you would pay an additional 4% of contributions, so total contributions of 12.7% of your pensionable pay: £6,085 each year.
>
> This is an increase of £1,917 for the year.
>
> As you receive relief from tax and national insurance contributions, based on current tax rates and your earnings, we calculate that the real cost to you of this increase is more like £1,303 for the year or £109 per month. So the actual cost is much lower (unless you are currently not paying tax).
>
> As part of the package of change under the proposals, you will also have received a pay award of 3.5% and Facilitation Payment to help mitigate any impact, details of which are shown below. In addition, you could further mitigate any increase by selecting a lower core benefit level, in which case you would pay lower contributions but your retirement balance would build up more slowly."

11. In relation to the withdrawal of the top up above 40%, the statement explained that Mr Brotherhood would be able to pay AVCs.

12. Changes were also made to the final salary scheme[1]. In brief the changes introduced a cap on the extent to which salary increases counted towards pensionable pay: none of the increase would count if pensionable pay was above £70,000 p.a., if pay was less than that, the increase was capped at CPI or 3% whichever was lower. The indexation measure and cap applied to pension increases accrued after 1 November 2018 was changed from RPI (capped at 5%) to CPI (capped at 3%).

13. It is common ground that the pension changes were driven by E.ON's desire to reduce pension costs and that the changes were adverse to the pension scheme members.

14. The FTT then made further findings concerning the fact the Facilitation Payment was part of an integrated proposal comprising many elements (FTT [76] – [83]) and also found the changes did not affect members' accrued pension entitlements (FTT [88]).

15. E.ON argued various legal principles supported its case that the Facilitation Payment was not "from employment". The FTT discussed these arguments in turn concluding in each case that it agreed with HMRC's contrary submissions. We deal with those issues and the FTT's reasoning on them in the context of the relevant grounds of appeal.

16. The FTT then considered what the Facilitation Payment was from. It concluded the Facilitation Payment was "from employment" because it was an inducement to provide future services on different terms. The payment could also not be separated from the integrated package which it was a part of and which changed the future relationship between E.ON and its employees. The payments made under, and as result of that package were, in the FTT's view, clearly "from" the employment.

17. It was explained to the FTT that HMRC and E.ON regarded Mr Brotherhood's appeal as a test case. That feature arose through agreement between the parties rather than any stay of other appeals by other employees before the tribunal or a formal lead case direction. While E.ON had deducted PAYE and NICs from those payments, in accordance with HMRC's view that the payment was subject to tax and NICS, it did not deduct tax and NICs from Mr Brotherhood's Facilitation Payment. This resulted in HMRC imposing a Regulation 80 PAYE determination of £758 and a s8 NICs decision in respect of NICs of £987.07 which E.ON then appealed against to the FTT.

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[1] The FTT Decision did not deal with the Final Salary changes in detail, it just referred to a cap on future pensionable earnings (at [7]). As the lack of detailed findings is one of the appellant's grounds of appeal we summarise the changes briefly. Although the relevance of the final salary scheme changes is disputed, their content is not, and the further detail we set out is derived from documents and evidence that were before the FTT.

Grounds of Appeal

18. By way of introduction it should be noted the appellant's four grounds of appeal broadly follow the structure of the FTT Decision, which in turn reflected how the case was put to the FTT. Accordingly the grounds deal first with various issues concerning the scope of fact-finding (Ground 1), the application of two particular strands of case-law, the so-called replacement principle (Ground 2) and the case-law (*Tilley v Wales)* on whether compensation in respect of pension expectations (as opposed to accrued pension rights) could amount to a source of payment that was not from employment (Ground 3). Adopting this order of grounds, because that was the order the grounds were argued before us, means however that the appellant's challenge to the FTT's reasoning on whether the Facilitation Payment was "from" employment for the purposes of the relevant ITEPA and NICs provisions is not dealt with until last (Ground 4). Despite that, it is important to recognise that this last issue – whether the payment was "from" employment for the purposes of the relevant statutory provisions - was ultimately the single fundamental question which lay at the heart of E.ON's appeal.

Ground 1 *– FTT disregarded plainly relevant facts concerning Final Salary category.*

19. Under this ground, the appellant argues the FTT misunderstood its fact-finding jurisdiction and wrongly closed its eyes to relevant facts relating to the Final Salary scheme.

20. At FTT[8] the FTT explained:

> "I pointed out to the parties that I only had the jurisdiction to hear the appeal which had actually been made. That concerned the Facilitation Payment made to Mr Brotherhood. There was no appeal against tax or NICs charged on a Facilitation Payment made to a member of the final salary scheme. I therefore had no jurisdiction to make findings of fact and law about those Facilitation Payments, and I have not done so."

21. The appellant submits this statement represents a clear error on the face of the decision. Although Mr Brotherhood was not a Final Salary scheme member, facts relating to that scheme were relevant to the status of the Facilitation Payment. The FTT had a duty to consider all relevant facts. HMRC accept facts relating to the Final Salary scheme are relevant insofar as they throw light on facts relevant to determining whether the Facilitation Payment to Mr Brotherhood was "from" the employment.

22. We agree with HMRC that a fair reading of FTT[8] does not reveal the FTT misunderstood its duty to make relevant findings of fact. That is clear from the immediate context. The sentence immediately before, in FTT[7], after summarising how the changes for Final Salary members were different to those for Retirement Balance members, explained how "HMRC nevertheless agreed to repay the tax and NICs on [Facilitation Payments] paid to members of the final salary scheme if E.ON succeed in its appeal in relation to Mr Brotherhood." The sentence immediately after

the excerpt in FTT[8] continued, in the same vein, to state HMRC's confirmation it would remain bound by that undertaking to final salary scheme members if E.ON won its appeal. All that the FTT meant, when it said it had no jurisdiction, was that it had no jurisdiction to determine whether Facilitation Payments made to final salary members were "from the employment"; in other words that it was not going to adjudicate on whether HMRC's stance regarding reading across the outcome for Retirement Balance members to Final Salary members was correct.

23. The appellant further argues the FTT erred in omitting material findings relating to the Final Salary scheme which it ought properly to have made and taken account of. Those members also received the Facilitation Payment for similar reasons to the Retirement Benefit members, namely diminution of contingent value of pension rights. The Facilitation Payment was the same for both categories of member, was negotiated and agreed at the same time, and was paid under one process. However, because the FTT misunderstood its fact-finding jurisdiction, it did not properly take account, for instance of the fact that the Final Salary members could not, unlike Mr Brotherhood, "buy their way out" of the changes.

24. Whether the findings the appellant suggests were indeed relevant depends on what view is taken of the legal principles relevant to the question of whether the payment was from employment. As the correct legal principles are the subject of the ensuing grounds, we consider the relevance of the Final Salary scheme facts when dealing with those grounds.

Ground 2 - *FTT erred in law in its approach to and application of replacement principle* (*Mairs v Haughey*)

25. The replacement principle, as set out in *Mairs v Haughey* [1994] 1 A.C. 684 (Lord Woolf's judgment (at [40])) is that a:

> "…payment made to satisfy a contingent right to a payment derives its character from the nature of the payment which it replaces".

26. On the facts of that case, which concerned contingent rights in a non-statutory enhanced redundancy scheme, it was accordingly held that as the redundancy scheme payment would not be from employment, a lump sum paid in lieu of the right to receive the redundancy payment was also not chargeable to tax as from employment.

27. Before the FTT, the appellant argued the Facilitation Payment replaced variously:

> (1) *Payments to members,* in that the member would receive these, not from employment, but from the employee's retirement balance pension pot.
>
> (2) *Member pension contributions,* in that the Facilitation Payment increased the earnings the member would need to use to pay the higher

pension contributions that were required to obtain the same pension benefits as before, those pension contributions being tax exempt.

(3) *Employer contributions*, in that E.ON would otherwise have made the higher pension contributions, which were tax exempt.

28. On 1) (pension payments to employee), the FTT agreed with HMRC this was factually incorrect: Mr Brotherhood could receive exactly the same retirement benefits. The FTT concluded that "what had changed was the ratio of employer and employee contributions to the pot from which the benefits were paid" ([115]). The FTT put to one side the 40% top up payment and returned to that at the end of the decision (at [133] and [134]), in essence saying that did not make a difference to the analysis that it had reached by that point that the payment was "from" employment).

29. Mr Maugham submits this ignored, first, that unless Mr Brotherhood chose (after the event - which was irrelevant) to increase his contributions, by remaining at the 40% level, his retirement balance was diminished and second, that Final Salary members could not ameliorate their contingent diminution in pensionable pay.

30. On 2) (employee contributions), the FTT explained there were two steps: first, the Facilitation Payment could be characterised as replacing the employee's earnings, second the employee could choose to make the higher contributions and get tax relief on that. Or if the employee selected the 20% level the employee could reduce the contributions but still get the Facilitation Payment. It thought replacement of earnings was a better characterisation (FTT [120] and [123]).

31. Referring back to Ground 1, Mr Maugham submits the FTT erred in law. First by failing to take into account that, for final salary members, they could not make larger payments to maintain the same pension benefits. Second by taking account of choices Mr Brotherhood could have (by moving to the 20% level) which were irrelevant. It was the benefit the payment replaced which was relevant not how the recipient then reacted to it.

32. On 3), the aspect Mr Maugham made central to his case, the FTT referred back to the better characterisation being that of replacing the shortfall in earnings members would experience if they wanted to maintain the same pension benefits. The FTT referred to HMRC's argument that the employee has the right to be paid a lump sum and/or pension and that E.ON's only obligation was to make such contributions as the scheme actuary calculated to underwrite prospective benefits but that greater or lesser amount of contributions would not affect the employee's rights as such (FTT [122] and [123]).

33. Mr Maugham submits this conclusion is perverse given the FTT's findings to the effect that the whole purpose of the changes was to reduce the contributions E.ON was making.

Discussion

34. The essence of this ground is that the FTT ought to have applied the replacement principle to conclude the Facilitation Payment replaced E.ON's tax exempt pension contributions. This point (point 3 above) was the one Mr Maugham placed the greatest emphasis on in his oral submissions before us.

35. Mr Bradley, for HMRC, referred to Chadwick LJ's observation in *EMI Group Electronics Ltd v Coldicott* [2000] 1 WLR 540 that it was not 'necessarily helpful to press the "replacement" principle too far in this field, where fine distinctions abound' (at 556E). (We note the reference to "field" concerned the various different permutations of payments made on termination of employment. But, noting that the excerpt of Chadwick LJ's judgment then continued "in so far as [*the principle*] is a useful guide", we agree the excerpt supports HMRC's submission.)

36. We consider Mr Bradley is right to highlight that the replacement principle is not an overarching principle but a guide which is helpful in some circumstances but not in others. It is just a tool of varying utility in answering the "from" employment question. While the FTT discussed the principle, it did so to address the submissions the appellant put to it. It was not ultimately a tool the FTT used in reaching its decision.

37. We agree therefore with HMRC there is no error of law in the FTT not deploying the replacement principle. Nevertheless, although that point might be relevant to whether any error of law was material to the outcome, to the extent the FTT decision did contain an analysis of the replacement principle, the question still arises whether FTT erred in not concluding the Facilitation Payment replaced E.ON's tax exempt contributions.

38. As Mr Bradley pointed out, the fact pattern here was not the more straightforward one, as it was in *Mairs* of a payment to the taxpayer being given up in the future for a sum paid now. It was not a situation where the thing being replaced could clearly be identified.

39. The payment was made in respect of pension scheme changes. What was the result of those? As the FTT identified in its observation at [115], which Mr Maugham agrees neatly summarises the fundamentals of the pension changes, the ratio as between employee and employer contributions changed. Apart from the 20% level, where there was no change, to get the same level of benefit, the employee would have to pay more, and the employer pay less. The member's rights stayed the same; they were more expensive to obtain. The employer's obligations (to pay what the Scheme actuary told it to pay) stayed the same but all things being equal were less expensive to meet.

40. In relation to the right to top up above 40% the member lost the benefit of an option whereby the employee could pay into a scheme with a higher level of benefit for a given contribution as compared with making AVCs. The Facilitation Payment replaced an option which may or may not have been exercised but, which as Mr

Maugham pointed out, nevertheless had value. As for the Final Salary employees, what they contributed in to the scheme was less valuable because they got out less: they lost the potential for higher pension because of the pensionable salary absolute cap and incremental cap.

41. In summary, it appears to us the unifying feature of the changes was the loss of pension benefits of a certain value. For a given level of benefit there were two ways of looking at that: more cost to the employee member or, less cost to the employer for the same benefits. Where benefits had been removed as in relation to the 40% top up, or in reduction of final salary benefits these similarly could be analysed as costing the employee more (because to get the equivalent elsewhere would cost more), or costing the employer less. The respective impacts on employee and employer were two sides of the same "value" coin.

42. In *Mairs*, the facts could have been, but were not, analysed from the point of view of the employer having to pay less and employee having to pay more than otherwise to get an equivalent non statutory redundancy benefit. The court did not have to look below the surface of the ready answer that emerged from the compensation payment replacing a distinct payment. We agree with Mr Bradley that the further one moves away from a straightforward fact pattern such as the one in *Mairs* of a payment replacing another payment there are limits to what the principle can reveal and that application of the principle to situations for instance where rights dependent on eventualities which may or may not happen is either unclear or yields equivocal results.

43. The FTT ended up approaching the principle from the employee's point of view – the employee had to pay more contribution from their earnings to end up with the same benefit. Given what we have said above, about the change relating to the reduction in value or loss of benefits and the lower amount of employer contribution, it would have at least been open to the FTT to frame what was being replaced as the employer paying less. However the fact that both findings were at least possible simply serves to show the limitations and sometimes equivocal outcome of the replacement principle.

44. For the purposes of dealing with Ground 2 it is sufficient for us to conclude, that the FTT's view of the better approach being replacement of earnings, was at least defensible: (putting aside the 40% top up) the employee had to pay a specified percentage more in contribution out of the employee's earnings. Conversely, the FTT was not *bound to* find the payment replaced employer contributions. Although it might have been open for it to analyse what was being replaced in those terms, the link to a decreased contribution obligation on the employer (so far as the benefits at the 25% to 40% level was concerned) was less clear cut than the employer's obligation, whose actual payment obligation – to pay what the Scheme actuary told it to – stayed the same. Any decrease in that amount arose as a consequence, as far as the pension changes were concerned, to the employee being obliged to pay more.

45. As regards the 40% top up, and in so far as the final salary members are to be considered relevant, there is no reason to suppose the *only* way to look at this was the loss of employer contribution towards these benefits. Those changes too might just as easily be seen as replacing the extra expense the member would have to fund, as a result of the changes, to obtain the same benefits as before. As above, the employer remained under an obligation to pay what the Scheme actuary told it to pay – the removal of the 40% top up and reduction in final salary benefits through the pensionable earnings caps simply made it likely, all things being equal, that the amount sought from the employer would be less. We accordingly reject this ground of appeal.

46. We think the FTT may well have recognised the equivocal nature of the principle when it described its conclusion as being the *better* characterisation of the principle. The FTT also did not deploy the replacement principle in its eventual reasoning, although as we will come on to discuss under Ground 4, its conclusion that under the principle, what was being replaced was salary, thus relating the payment to an employment source may have led to the FTT not considering the compensation for adverse pension arrangement changes as a possible or substantive reason for the payment.

Ground 3 *– FTT wrongly distinguished between compensation for accrued pension rights vs. compensation for future pension rights* (*Tilley v Wales*)

47. This ground of appeal concerns a dispute over the principle established by the House of Lords authority *Tilley v Wales* [1943] AC 386. The appellant argues *Tilley* creates a binding principle that payment for removal of pension expectation was not "from" employment. That reading of *Tilley* was confirmed by the FTT in *Kuehne + Nagel Drinks Logistics Ltd and ors v HMRC* [2009] UKFTT 379 (TC).

48. The FTT in *E.ON*, in agreement with HMRC, considered the ratio of *Tilley* did not extend to an expectation of a future pension but was restricted to compensation in relation to accrued pension rights. It therefore disagreed with Judge Hellier's statement to the contrary in *Kuehne (FTT)* (FTT[107]). *Tilley* did not assist, as on the facts, Mr Brotherhood's accrued pension rights had not been altered (FTT[106]).

49. The relevant facts of *Tilley* were that under an agreement between the taxpayer and the company he was managing director of, the taxpayer received a salary of £6000 p.a. The company also agreed that in the event of the taxpayer "ceasing from any cause whatsoever to be managing director of the company" the company would pay him (and if relevant his personal representatives) a pension of £4000 p.a. for 10 years from the date of cessation. The company later agreed to pay the taxpayer £40,000 in consideration of the taxpayer releasing the company from the prospective obligation to pay the pension and for a future salary of £2000 p.a.

50. Viscount Simon LC considered that "Neither the pension nor the sum paid to commute it constituted…profit from the office" as if the pension was paid after the

ceasing to hold office it would have been assessable under different taxation rules for pensions. A pension was "in itself a taxable subject-matter distinct from the profit of an office, and, if an individual agrees to exchange his right to a pension for a lump sum, that sum is not taxable under Sch E".

51. He went on to explain that this conclusion was in accordance with the majority view of the House of Lords in *Dewhurst v Hunter* 16 TC 605. That case concerned a payment to a company director of £10,000 first for a reduced salary and second in place of his rights under a company article of association. Those rights provided for compensation of loss of office equal to the total of his remuneration for the preceding five years where a director died or resigned or ceased to hold office for a cause not relating to the officer's conduct or competence. Viscount Simon viewed the ratio in *Dewhurst* as follows. The majority held the £10,000 was "a sum of money paid…to obtain a release from a contingent liability as distinguished from being remuneration under the contract of employment. Lord Thankerton [one of the majority] emphasized the further point that the payment was not in the nature of income at all". Viscount Simon also thought that a lump sum paid to commute a pension was in the nature of capital.

52. Lord Thankerton (who, as indicated, also gave judgment in *Dewhurst)* said he had nothing to add to Viscount Simon's view regarding the £40,000 being referable to commutation of the pension liability. He continued: "As in *Dewhurst's* case …this payment did not arise from the office of director, but in spite of it."

53. Lord Porter considered *Dewhurst* decided the question. He disagreed there was any distinction arising between a sum paid in commutation of pension rights to a director who was still serving as to one whose service had ended; "a sum received on the sale or surrender of pension rights is not taxable under sch. E because it is neither pension nor annuity and comes under no other heading of that section." He doubted much assistance could be obtained from "the antimony between capital and income". In response to an argument the sum was deferred pay he considered "It is a sum paid for the release of an obligation to provide a pension and it is not shown to be given instead of deferred pay."

54. Before us, Mr Maugham made clear he accepts facts of *Tilley* are concerned with accrued rights to pension. In his submission however that was not a relevant fact, as the principle established by the case went wider. That was confirmed by the House of Lords' reliance, without any limitation, on *Dewhurst*, the facts of which concerned a contingent right.

55. Mr Bradley emphasises how the House of Lords acknowledged the facts of the case to be special and points out the obligation in *Dewhurst* was of the same character – an existing obligation one albeit contingent on future eventualities - as the one in *Tilley*. He suggested the proposition underlying *Tilley* was that periodic payments of income which are commuted to a lump sum are viewed as capital.

Discussion

56. We agree with HMRC that there is no real difference between the obligations at issue in *Dewhurst* and *Tilley*. Both the obligations were ones which existed at the time the relevant sum paid in compensation for release of those obligation was made. The obligation in *Dewhurst* was subject to the contingency of the director not being a "bad leaver" but it was an existing obligation nonetheless.

57. However we disagree with HMRC that the ratio in *Tilley* is restricted to situations only where a sum is paid in respect of accrued pension rights in the sense that is understood for conventional pensions where rights are built up over time.

58. The core idea in *Tilley* is that the sum in question was to release other obligations that were not remuneration. What was crucial was that the sum was paid in respect of rights that were not rights to remuneration but something else. There was no discussion of the specific nature of the obligation. It is true the capital nature of the payment was referenced, but it appears in Viscount Simon's speech as an additional point. He also did not include it within his description of the ratio of *Dewhurst* and Lord Porter did not think the antimony between capital and income helpful. The reference in *Tilley* to *Dewhurst* makes clear the release of obligations which exist, but which are contingent on something happening, or not happening in the future, are also within contemplation.

59. In our view, the reasoning in *Tilley* and its endorsement of *Dewhurst,* is that where the liability, in respect of which the sum is paid, is not from employment (in that case because it was from a pension) the sum paid in respect of release is equally not from employment. This reflects two consistent motifs that recur in the authorities: 1) the significance of an employment source: if the payment is from something else, it is not from employment 2) the replacement principle: if the thing the sum is replacing is not from employment then the sum replacing that will also not be from employment.

60. The facts in *Kuehne* concerned a transfer of business where, under the TUPE regulations relevant there, the employees kept accrued rights in the transferor undertaking pension scheme but lost their rights to accrue future rights in that scheme, which was more generous compared with the transferee business's pension scheme. The taxpayer (who as in this case was represented by Mr Maugham in the appeals before the FTT and the onward appeal to the UT) and HMRC made the same arguments, as they do before us, in relation to the ratio in *Tilley*. Judge Hellier transposed the analysis in *Tilley*, which was couched in the terms of the predecessor legislation, to the modern day ITEPA provisions concluding that: "unless specifically brought into tax in Pt 9, a sum received simply and solely in exchange for renouncing a pension right is not taxable under Part 2 of ITEPA"([85]). He rejected the argument *Tilley* should be distinguished and held that:

> "a sum paid simply and solely to recognise the removal of a voluntary pension or the removal of an expectation of a pension should be treated

> in the same way as a sum paid solely in exchange for a vested pension right and therefore not be treated as from employment" ([86]).

61. The decision was appealed further to the Upper Tribunal[2] and then to the Court of Appeal[3]. The judgments did not deal with the principle to be extracted from *Tilley*; rather the issues were concerned with interpretation of the "from employment" test when there were two reasons, one taxable (to avoid disruption and possible strike action) and other not (changes to pension rights). The Court of Appeal held it was sufficient the taxable reason (threat of strike action) was a substantial cause of the payments. While Mr Maugham submits it is significant the principle he supports was not contested by HMRC in that case, and that if the payment in respect of pension rights was not taxable as he maintained, there would have been no live issue regarding how taxable and non-taxable reasons should be treated, we agree with HMRC that there is nothing in these points which takes the matter further. The assumption underpinning the decisions in the Upper Tribunal and the Court of Appeal that where the payment was made because of loss of pension rights this was non-taxable was taken from the parties' position before the court; there was no judicial consideration on the issue.

62. Standing back, it seems to us that there is a spectrum of pension rights and expectations and the tax treatment of payments in respect of those, at play in the above authorities. At one end are accrued pension obligations which result in a current right to a specified sum (*Tilley v Wales*) (*Dewhurst)*. At the other are expectations of rights one might hope to get in the future (*Kuehne FTT*). In the middle are all sorts of pension related rights, which while they do not result in payment of pension, concern how a pension will accrue in the future. HMRC's stance in relation to the Facilitation Payment is at the accrued obligation end. The approach in *Kuehne Nagel FTT* encompasses the full spectrum of rights and expectations. It seems to us the facts of this case are in the middle: Mr Brotherhood had an existing right 1) to get a pension predicated on a certain level of future contribution 2) to top up beyond 40% predicated on a certain level of future contribution. These were, in substance, rights to do with how his pension would accrue in the future. We think the principle established by *Tilley* certainly extends to payments in respect of existing obligations of these sort. However, even if the technical legal analysis is that what the Retirement Balance category members had did not constitute legal rights (because they were subject to rules changes which did not, in terms, require member consent) but encompassed related rights arising out of rights to be consulted on changes and expectations on future accrual terms, there is no reason in

[2] [2010] UKUT 457 (TCC)

[3] [2012] EWCA Civ 34

our view to draw any distinction in treatment[4]. We see no difference in principle between the characterisation of sums paid in respect of loss of accrued pension rights on the one hand, and sums paid in respect of a diminution in the practical value of expected future benefits on the other. In both cases the sum is from something else, and not from employment.

63. We therefore consider the FTT erred in law insofar as it read the ratio of *Tilley v Wales* too narrowly such that it only encompassed compensation in respect of accrued rights. That error led it to conclude the principle in *Tilley* was not applicable because Mr Brotherhood's accrued pension rights stayed the same. (It was not suggested to us that there was any independent error of law in respect of Ground 1. The appellant does not suggest the position regarding accrued rights staying the same was any different for the Final Salary members.)

64. HMRC argue that even if the ratio of *Tilley* extended to loss of pension expectations, then that does not help the appellant because Mr Brotherhood's pensions expectations were the same: he could continue to build up in the same way after the changes as before. We do not think that accurately reflects the changes that happened as regards the substance of his pension expectations. Mr Brotherhood's right to accrue a given level of pension benefit and top up benefits, if so elected, at a given cost were changed. He had to pay more to get the same benefits as before, or if he did not want to pay more, by dropping down to the 20% level, he would receive lower pension benefits.

65. HMRC also argue that even if Final Salary scheme members suffered a loss of pension expectation (by reason of the cap on pensionability of future pay increases) and the payments in respect of that were non-taxable, that would not mean the tax treatment for the Retirement Balance scheme was similarly non-taxable. Furthermore, the conclusion would not make a difference to the outcome because the FTT found the payments were an inducement to provide services and an indissociable part of the "integrated package". The Court of Appeal in *Kuehne* established that it was enough if

[4] The FTT noted (at [18]) that E.ON recognised the legal position was complex and that to succeed in making changes the support of the Unions was required. (E.ON's witness, Mr Osborne, Head of Pensions, outlined various legal risks that were identified with amending the Defined Benefit rules including: failure to consult, breaching power of amendment restrictions, exercising an amendment power in breach of an employer's implied duty of trust and confidence, falling foul of anti-discrimination legislation, breaching E.ON's statutory duties arising from various statutory provisions which protected member benefits of those employed at the time of privatisation. The FTT found him to be a wholly honest and credible witness. While the FTT rightly disregarded the parts of his witness statement setting out Mr Osborne's view of the law, we set the above legal risks out not in order to confirm that these were indeed legal risks but simply by way of background for why it was considered that E.ON recognised the legal position was complex.)

employment was a substantial cause even if there were other no-employment reasons for it.

66. We consider that these submissions go to the materiality of the error of law. We agree that it does not follow from our view, that the FTT construed the ratio of *Tilley* too narrowly, that the Facilitation Payment was inevitably taxable. The particular reasons a payment, whose tax treatment is in contention, was made, whether it was from employment, by way of compensation for pension rights, something else or for a mixture of reasons will depend on the particular facts and circumstances of the case. All that the principle in *Tilley* establishes is that if, as a matter of fact, it is concluded that the payment was compensation for loss of pension rights and/or expectations as to those (and, in line with *Kuehne CA,* there was no substantial employment cause) then the payment was not taxable as "from" employment.

67. We consider the FTT's error of law to be material in this case nevertheless. The finding on what a payment is "from", whether viewed as mixed question of law and fact, or fact, calls for an evaluation of all relevant facts and circumstances. By dismissing the relevance or weight given to situations where pension expectations rather than accrued rights were being altered, it can be seen how an FTT would be more inclined to not think they could count as a cause for the payment. Where an FTT misdirects itself on the law in a way that will, on the face of it, affect its approach on the "from" question it cannot be assumed that its conclusion remains sound. We therefore consider the error material and that the FTT decision should be set aside. We deal with the issue of whether the decision should be remade by us or remitted to the FTT once we have considered Ground 4.

Ground 4 *- FTT erred in law in considering what the payment was "from"*

68. After rejecting the appellant's case on the replacement principle and *Tilley v Wales,* the FTT proceeded to consider what the Facilitation Payment was from. The FTT set out the parties' competing submissions: HMRC's was that the payment was paid for the employee agreeing to change his conditions of employment for the future. The appellant's was that the payment was paid, not for past or future services but for a reduction in the employee's pension rights ([126]-[129]). The FTT preferred HMRC's submissions.

69. The FTT's reasoning was expressed as follows:

> "130… I agree with Mr Bradley. The Facilitation Payment was, to use Lord Templeman's phrase "an inducement to…provide future services" on different terms. In other words, in exchange for the employees in the retirement balance scheme agreeing to a change to their future conditions of employment. It was thus "from" the employment within the normal meaning of that term.

> 131. Moreover, as is clear from my findings of fact, see in particular §76 to §87, the Facilitation Payment did not stand alone, but was part of an "integrated package". This had been negotiated and agreed between E.ON and the Unions, and was subsequently agreed with union members and the members of the pension schemes. The package included not only the Facilitation Payments and the changes to future contributions, but also a two year pay deal for all employees, a commitment by E.ON not to make further amendments to the pension arrangements for five years, and a set of "employment commitments", which remained in place for two years.
>
> 132. The package changed the future relationship between E.ON and the employees, and the payments made under and as a result of that package were clearly "from" the employment. The Facilitation Payment cannot be separated out from the rest of that integrated package. I note that this finding is entirely consistent with Mr Osborne's own evidence, see §27, that there was "no specific focus on the Facilitation Payment"; instead, the changes were "a complete package" and he "wouldn't isolate the Facilitation Payment".

70. Earlier in its decision (at FTT [11]) the FTT summarised its reasoning for refusing E.ON's appeal, again in terms of its agreement with Mr Bradley's submissions (set out at FTT [10]) that 1) *Tilley* did not apply because the payment there was for surrender of a fixed and vested pension right whereas here there was no change to vested rights 2) the better analysis of the replacement principle, insofar as it was useful guide, was the Facilitation Payment replaced earnings and 3) the Facilitation Payment was "from" the employment "because it was made in exchange for employees agreeing to change their future conditions of employment". The FTT continued:

> "…Moreover, as is clear from the findings of fact, the Facilitation Payment did not stand alone, but was part of an "integrated proposal" governing the future employment relationship between E.ON and its employees. This had been negotiated as between E.ON and the Unions, and included not only the Facilitation Payment but also pay increases for all employees, E.ON's agreement not to close the final salary and retirement balance schemes and various "employment commitments". It is not a realistic view of the facts to separate the Facilitation Payment from the rest of that integrated package."

71. The FTT concluded this section of its decision (at FTT [133] to [134]) by acknowledging that top up over 40% option was the only element of the original pension changes which was entirely removed by the changes, but noted Mr Brotherhood had not taken this option and it was only used by 7% of scheme members. It continued:

> "It is clear from the Court of Appeal's decision in Kuehne that a payment is "from" the employment if employment is a "substantial cause" of the payment. I have concluded for the reasons set out above that Facilitation Payment was "from" the employment and that conclusion encompasses the removal of this option as well as the other elements of the package."

72. Although there is no challenge to the underlying findings of fact the FTT made, under this ground, the appellant submits the FTT erred in its analysis of whether the payment was "from" employment and argues that the FTT's conclusion that the payment was from employment was not one that was open to it.

Discussion

73. The Court of Appeal's decision in *Kuehne,* was the most recent higher authority discussing the relevant legal principles in this area which we were referred to. It helpfully considers the approach to be taken when applying the law to the facts and does so in a context where as in this case compensation in relation to pension changes was in issue. The FTT, it will be recalled, found as fact that there were two indissociable reasons for the payment in issue: one was to avoid disruption and possible strike action and the other involved changes to pension rights. In the Court of Appeal the appellant argued the FTT erred for a number of reasons including that it had wrongly failed to weigh all the reasons for a payment against each other in order to determine whether the payment was from employment (see [27]).

74. Mummery LJ at [33]) explained that "from" in this statutory context indicated "as a matter of plain English usage, that there must, in actual fact, be a relevant connection or link between the payments to the employees and their employment. He went on to confirm the appellate tribunal or court's function was not to

> "re-decide or second guess the primary facts their proper function being limited to questions of law such as whether the FTT misinterpreted the law, or misapplied it to the facts, or made perverse findings of fact unsupported by any evidence, or reached a conclusion that was plainly wrong"

75. Mummery LJ held there was no misdirection of the law ([43]) or misapplication of law to the facts (at [44]). In relation to the necessity to find a "relevant connection or link" between the payments made to the employees and their employment the FTT had made "a clear finding of fact that the payments were made to avoid industrial action; that the threat of strike action was a "substantial cause of the payment"; that the payments were in reference to the services of the employees rendered and the nature of a reward, inducement or incentive to work willingly for the joint venture company in the future." Those facts were sufficient to establish the necessary connection or link between the payments and the recipients' employment. The "weighing up" emphasised by the appellant in that case, had been properly carried out at the correct stage, namely when the FTT evaluated the evidence and reached its conclusions on the facts relevant to the question of whether the payments were from employment. The statutory question was answered by the finding that the threat of industrial action was a substantial cause of the payments. There was no further exercise of weighing up the two dissociable reasons for the payment ([46]).

76. Patten and Etherton LJJ both agreed the taxpayer's appeal should be dismissed with Patten LJ adding his own reasoning. After stating the legal test by reference to authority ([51]) Patten LJ referred at [53] to the fact finding judge undertaking a "process of evaluation" to "make findings of primary fact based on evidence as to the reasons and background to the payment and then to apply judgment as to whether the payment was from employment rather than from something else". He continued: "To this extent, I agree with the appellants so far as they submit that having determined the causes of the payment that process of characterisation must then follow". Patten LJ noted at [54] that the FTT had set out the reasons for the payment and that the court could not "go behind them". The FTT had correctly carried out the exercise of determining that employment, even if it was not the sole cause, was sufficiently substantial so as to "characterise the payment as one from employment. The FTT had found that pension rights were historically the source of the dispute "but things moved on and the possibility of industrial action became the reason for the payment." Patten LJ thus rejected the appellant's claim there was no "weighing up" and dismissed the appeal.

77. Both Mummery LJ and Patten LJ's judgments therefore envisaged that there should be a "weighing up" or evaluative process to be carried out in respectively the fact-finding of reasons for the payment and the characterisation of the facts for the purpose of the statutory words. However upon analysis the conclusion was the FTT had carried out this process correctly in making its finding on reasons for the payment (Mummery LJ) and in characterising the reasons (Patten LJ).

78. For the purposes of the appeal before us we draw the following principles regarding the proper approach to the statutory question and the treatment of the FTT's fact-finding on appeal:

> (1) The FTT has a fact-finding role in determining the reasons for the payment.
>
> (2) Determining what the reasons were, as a matter of fact, involves an evaluative process or "weighing up".
>
> (3) Having found the reasons – there is then a legal question of characterisation – if employment is found to be a substantial cause that is enough to satisfy the statutory words.
>
> (4) An appellate court will not go behind the findings on reasons being findings of fact unless there is an error of law (such as misdirection or misapplication of the law, perversity in view of the findings or a conclusion that is plainly wrong).

79. Whereas Mr Bradley portrays the conclusion the FTT reached, that the payment was an inducement for future service as one of fact, Mr Maugham submits the ultimate question is a mixed question of fact and law. We think little turns on the distinction for our purposes as each of the ways Mr Maugham puts Ground 4 amount to him saying the FTT misdirected itself on the law, or misapplied the law to the facts, or reached a

decision that was perverse given the facts which all amount to errors which are capable of being an error of law.

Overarching point of Ground 4

80. The overarching point made by E.ON's Ground 4, that the FTT erred in the way in which it analysed the question of whether the Facilitation Payment paid to Mr Brotherhood was "from employment", bears consideration in its own right. The question of what the payment was "from" was one the FTT rightly identified as "fundamental" at FTT [125]).

81. It is significant, in our view, to recognise that the FTT's conclusion, that the payment was "from employment" arose in the following context where the FTT had:

> (1) Rejected the idea that the Facilitation Payment was paid in exchange for Mr Brotherhood giving up any existing pension rights (*Tilley*) – his accrued rights remained intact. He was not giving up anything that had already crystallised. All that was happening was that he was being asked to change matters moving forward.
>
> (2) Rejected (a) the idea that the Facilitation Payment was to replace the payments Mr Brotherhood was originally intended to get on retirement – because he could still get those benefits; and (b) the idea that the Facilitation Payment was to replace the contributions the employer would otherwise have made – because in fact the employer's obligation to make contributions was the same: it was the obligation to make the balancing payment as advised by the scheme actuary, and it would still do so, and so that obligation was not being "replaced" by anything.
>
> (3) Accepted the idea that, if the Facilitation Payment was replacing anything, it was intended to replace the additional salary Mr Brotherhood would have to pay into his Scheme to maintain the same overall level of benefits. But if regarded as replacement salary, then the Facilitation Payment was from employment, though Mr Brotherhood could obtain tax relief later if he chose to use the Facilitation Payment to fund his pension.

82. In terms of the approach discussed above by reference to *Kuehne CA*, the FTT's evaluative process to its fact finding on reasons resulted in a conclusion that the Facilitation Payment was in relation to a change in future conditions of employment. When the FTT then came to make a judgment as to whether that was "from employment" there was only one main reason for the payment which was obviously connected to the employment. While not entirely clear, it appears the FTT may have been prepared to consider the 40% top up could present another reason but, if it did, it is plain the FTT considered that did not detract from the employment reason being the substantial cause of payment – and per *Kuehne* – that was enough for the test to be met.

83. In our judgment, the finding the payment was in relation to a change in future conditions of employment (and not therefore also or alternatively in relation to something else) is clearly vulnerable to challenge. Although the finding was one of evaluative fact, and therefore one an appellate tribunal will not lightly interfere with, it was arrived at on the basis of a legal misapprehension that only accrued pension rights could amount to an alternative payment source to employment. The evaluation process which the FTT undertook, and which led to the finding the reason for the payment was to reward future service, wrongly omitted to consider that a reason, or an alternative reason for the payment was to compensate for adverse changes to the recipient's pension arrangements. The misapprehension arose out of the FTT's analysis on *Tilley v Wales*. It also arose, we consider although to some lesser extent, because of the FTT's earlier conclusion regarding the replacement principle that the better view on what was being replaced was that it was the employee's salary – something which was obviously therefore employment related.

84. The fact the FTT appeared to have accepted (at [133] to [134]) that the removal of the 40% top up (but none of the other pension arrangement changes) might be capable of being an alternative source for the payment lends support to the view that the other pension changes apart from the removal of the 40% top up were discounted from the outset as being capable of amounting to an alternative source for the Facilitation Payment. Although those other changes technically left the relevant obligations intact, in reality they did result in a change to value of the pensions arrangement.

85. The facts relating to the pension arrangement changes undoubtedly would have resulted in pensions arrangement compensation being a serious contender in terms of the potential sources for the payment and thus to the proper characterisation of the Facilitation Payment. The real-world effect to Mr Brotherhood of agreeing to a change in his Retirement Balance Scheme pension arrangement was that the financial value of that Scheme was to be worth less to him in the future than it was before. The point is reinforced if one considers that, as regards the Facilitation Payment, the Retirement Balance Scheme members were treated in just the same way as the Final Salary Scheme members. Consistent with our discussion at [40] above regarding the unifying feature of the changes being loss of value, both groups were treated as having lost something of value in their capacity as members of their respective Schemes. It was irrelevant that the Retirement Benefit Scheme members could in practice buy their way out of the difficulty, and accrue the same benefits, by paying more. Even if they did, they would still be worse off overall, just as the Final Salary Scheme members were.

86. The Facilitation Payments were only paid to those who were affected as pensioners under the Schemes, and not to anyone else. (This is clear from the evidence before the FTT and the findings it made. Mr Osborne's evidence to the FTT was that at the time of the changes to the pension arrangements in 2018 E.ON had approximately 9500 UK employees (of which 1400 were in the Final Salary category, 1,100 in the Retirement Balance category (together the Defined Benefit Pension Scheme), 6500 in the Defined Contribution scheme and 500 were not in any of the company's pension

scheme – (FTT (16) and Mr Osborne's witness statement ([11])). His evidence was that only those members of the Defined Benefit Pension Scheme were eligible to receive the Facilitation Payment which was approximately 2500 individuals (paragraph 38 of his statement). The FTT noted at the outset (at [2] and [7])) that the Facilitation Payment was paid to members of the retirement balance scheme and the final salary scheme and went on to find (at [68]) that the Facilitation Payments were paid in cash to 2,238 pension scheme members.[5]) Although not determinative, that fact would have added to the picture that Mr Brotherhood was being paid the Facilitation Payment in his capacity as member of the Retirement Balance Scheme. That was because his rights under that Scheme – although technically intact – had been devalued. (In this respect, further to what we say at [23] under Ground 1, this relevant fact concerning the Final Salary scheme was overlooked – to that extent there is arguably also an error of law which related to Ground 1).

87. While the FTT's omission (to properly consider the possibility that the pension arrangement changes were a reason for the payment) was consistent with the way the FTT had rejected the appellant's argument on *Tilley v Wales*, for the reasons we have already explained under Ground 3, we consider the FTT's analysis in that regard was wrong in law.

88. In terms of the process envisaged by *Kuehne CA* (which we summarised in four points at [78] above) there was therefore an error of law in the FTT's approach to its fact finding based on a legal misapprehension at point 2) (evaluation of reasons). That error was material as it then had a knock on effect to point 3) (judging whether reasons satisfied the statutory words).

89. We therefore agree with E.ON that the FTT erred in law in its analysis that the payment was "from" employment.

90. We suspect part of the reason the FTT fell into error may have been the way in which the case was put to the FTT which encouraged it first to engage with the facts through the lens of particular legal principles whose relevance and application were contested rather than focussing on the single statutory question of whether the payment was "from" employment. We have, in dealing with Grounds 2 and 3 described how the FTT carefully dealt with each of the points made in respect of those arguments on the *Tilley v Wales* ratio and the replacement principle (although we of course differ from the FTT's analysis of the ratio of *Tilley*). However, analysis of those grounds first did

[5] The approximate shortfall between 2,238 employees and the approximate total of 2,500 Defined Benefit scheme members was accounted by the FTT's further finding at [68] that 262 pension members received amounts which they contributed as AVCs to the group AVC pension facility. (Mr Osborne explained in his evidence (at [39]) that certain members could opt for additional pension contributions to be made or have the Facilitation Payment paid in as AVC. The tax treatment of those payments is not within the scope of this appeal.

not help the FTT to step back to look afresh at the overall picture in order to determine whether the Facilitation Payment was "from" employment or from something else. Accordingly, following on from the outcome of its analysis of *Tilley*, Mr Brotherhood's accrued pension rights were not altered. This meant the FTT did not, as we have discussed, consider pension source compensation as a serious contender to employment. In addition, as a result of the discussion in relation to the replacement principle, the overall impression the FTT was left with was that Mr Brotherhood's benefits had not changed. Again that would not have encouraged the FTT to recognise the key facts concerning the diminution in value of his pension rights in reality.

Error in treatment of Facilitation Payment as part of package?

91. Mr Maugham also argues that the FTT erred in grouping together, and determining the fiscal character of the Facilitation Payment by reference to other elements in the package. The fact a 3.5% salary increase was a reward for future service said nothing about the character of other payments. In any case, as indicated by HMRC's pleadings and skeleton, both sides accepted that package was in return for pensions rights diminution.

92. As regards the payment being part of an integrated package of changes the appellant does not dispute that as a matter of fact. Again we see some force in Mr Maugham's points that there was an analytical error here too. The fact the 3.5% salary increase was a reward for future service said nothing about the character of other payments. The fact the payment was part of package did not relieve the FTT of looking at what the payment was for. The FTT did not acknowledge that payments within a package might nevertheless have a different fiscal character. In other words it did not consider the Facilitation Payment could have a character as a pension change source payment yet still be part of a package of wider measures.

93. Moreover, even if it was part of a package that then required an analysis of what the package was for. The employer offered employer commitments to all, and a pay rise to all, (but as already mentioned, the Facilitation Payment only went to the Retirement Balance and Final Salary category members). These other elements of the package which were offered to all employees, including the pay rises effected by changing employment contractual conditions that would otherwise apply, were conditional on the pension changes going through.

94. On the employees' part, all that the employee offered was consent to the pension changes. (We do not think the point Mr Bradley made, that member consent was not actually required to the pension scheme, assists. As indicated above (see footnote 4 at [62]) the employer viewed the consent as necessary for trade union purposes and to make the changes watertight legally). Together, these features all pointed towards the payment having a pension changes compensation source.

95. It happened that some of the particular incentives (of pay-rises and employer commitments) and disincentives (the lack of stipulated pay-rise if the offer was not accepted) offered as part of the package were obviously connected to employment especially insofar as the pay was in respect of employment. However that did not alter *the reason* such employment related incentives and disincentives were provided in the first place which was to procure the employee's consent to adverse changes to the value of their pension arrangements. Again, we consider that the fact the *package* might have a pension source was wrongly discounted because of the FTT's legal misapprehension that compensation in respect of changes to pension expectations could not in principle amount to an alternative source to employment for the payment.

96. We therefore conclude the FTT erred in law its analysis of whether the payment was "from" employment because:

> (1) as a result of its misapprehension of the law (the ratio in *Tilley v Wales*) it discounted the adverse changes to pension arrangements as a possible source for the Facilitation Payment and
>
> (2) it made an analytical error by treating the fact the payment was paid as part of a package meant it bore the same fiscal character as other elements in the package. (The analysis of the package was in any case wrong because the misapprehension of the *Tilley v Wales* error meant the pensions compensation source of the package was not recognised.)

97. These errors are sufficient for the appellant's ground to succeed. Moreover, as we indicate below, we consider these errors were material to the FTT decision and that the decision must therefore be set aside. We will therefore deal with the other three points Mr Maugham made under Ground 4 briefly.

98. First, Mr Maugham repeated the submission he made before the FTT that the Facilitation Payment was not a reward for past services because it was paid irrespective of the length of time an employee had been with E.ON. Nor was it a reward for future services: the FTT was wrong to find the payment was an inducement to enter future service on different terms when it had found the payment was not conditional on future service (FTT[69(5)] and [106]). The FTT did not however make any finding that the payment was for past service. As regards future services, as is clear from the authorities Mr Bradley took us to, and as we understood Mr Maugham to accept in his reply, it is possible for a payment to be an inducement to provide future services even if it is not linked to a contractual obligation to enter into or remain in employment. (In *Laidler v Perry* [1966] A.C. 16 Christmas vouchers were taxable even though there was no contractual commitment on the part of the employee to remain in service. In *Hamblett v Godfrey* [1987] 1 WLR 357, the £1000 payment made to a GCHQ employee in recognition of loss of union membership rights was taxable as from employment in circumstances where no undertaking was imposed on the employee to stay on at GCHQ.)

99. Second, Mr Maugham submits the FTT erred in focusing on whether the payment arose from the "employment relationship" by failing to take account (per Lord Radcliffe in *Hochstrasser v Mayes* [1960] 1 AC 376 (HL) that it was not enough to satisfy the test "that an employee would not have received it unless he had been an employee". The FTT did not however proceed on the basis that the payment was from employment simply because the employee would not have received it had they not been employed by the appellant.

100. Third, the FTT's finding the payment was in exchange for a change in future conditions of employment was unsupported by evidence. By reference to a number of documents (The Company and Trade Union Update (FTT [24] and [25]), the Memorandum of Understanding (FTT [28] and [29]), and the individualised pension statements (FTT [39] and [55]) which distinguished between pension changes and employment commitments and which linked the pay settlement to the pension changes. The changes, submits the appellant, were to the pension terms, whereas the employment contract which governed the terms of future service stayed the same. We agree with Mr Bradley's submission that, properly understood the FTT was not saying that the employment contract had changed and thus the documents and evidence the appellant refers to above do not assist the appellant in that regard. Rather the FTT was here referring to a change in one aspect in of the wider employer and employee relationship namely that the employee's future funding of the retirement balance scheme would go up (i.e. they would in practical terms be paying more contribution out of their salary) and all other things being equal E.ON's funding would go down. The logic of its decision, given its final conclusion, entails that the pensions change made working at E.ON less attractive, although the FTT made no finding as such on this. (As will be seen the findings made regarding the various documents the appellant refers to above are nevertheless relevant to the wider picture when remaking of the FTT's decision.)

Remaking decision

101. We have concluded that Grounds 3 and Ground 4 identify linked errors of law. Those errors affect the FTT's ultimate conclusion and are material. They lead us to the view that we should set aside the decision. As neither party suggested (putting aside the lack of final salary scheme findings the appellant complains of under Ground 1) that we need look beyond the detailed findings of fact the FTT made, we consider we can, and should, remake the decision rather than remit it to the FTT. As we have said above, the fact the appellant has succeeded in showing under Ground 3 that its interpretation of the *Tilley* is the correct one does not mean there is not nevertheless a factual determination to be made as to what the payment was from.

102. We recognise that the FTT made a clear finding the payment was an inducement to provide future services on different terms. However, for the reasons we have discussed, that finding is vitiated by the error of analysis arising from the FTT's misapprehension of the law. In wrongly discounting pension changes compensation as

a potential source for the payment, it can be seen how an FTT would gravitate to attributing the source for the payment to employment and not something else. We do not therefore adopt the factual finding the payment was an inducement to provide future services in remaking the decision.

103. We have nevertheless considered whether there are any underlying findings in the FTT Decision which might, independently, support a conclusion the Facilitation Payment was from employment. Beyond the point that the payment was an integral part of a package – which, in our view, in any case tended to show the payment was made by E.ON to compensate for the pension changes because the package was dependent on those changes – the FTT did not identify any other underlying facts which supported a conclusion that the payment was from employment. It is thus difficult to see what basis, as Mr Maugham points out, apart from assertion, the FTT had to say the payment was an inducement to provide future services on different terms. The lack of findings stands in contrast, for instance, to the FTT's findings in *Kuehne* where, as the Court of Appeal noted, there were clear findings of fact based on the evidence (in that case regarding the likelihood of strike action, and the desire to avoid such on the part of employees and employers in order for there to be a smooth transition to the new venture as set out at [24] of *Kuehne FTT*).

104. Having considered all of the FTT's findings on the evidence before it we consider these point clearly to the payment not being "from" employment but from changes made to the pension scheme. In addition to those identified in the appellant's Ground 4 (see [100] and the features we have already discussed above under Ground 4 in particular that the Facility Payment only went to affected pension scheme members) we note the following findings:

> (1) The Union update provided in February 2018 linked employment plans and commitments regarding job losses and outsourcing to progress on pension settlement (in other words those commitments were seen as being procured as part of a bargain for pension changes). The Facilitation Payment came up in those discussions. (FTT [21][22])
>
> (2) The Memorandum of Understanding signed by E.ON and Unions was described as "summarising [E.ON and the Union's] agreement on implementation of various changes to the Company's pension schemes along with associated facilitation measures for colleagues impacted by these changes") (FTT[28])
>
> (3) The individualised statement section of the Facilitation Payment stated: "We recognise that the decision to propose change to your pension benefits will cause uncertainty. This has been a difficult decision and to recognise the fact, we will offer all members a lump sum payment ("Facilitation Payment"). (FTT[47])

(4) The covering letter to the offer describes the offer as being to a person "as a member of the Retirement Balance category of the E.ON UK Group of the Electricity Supply Pension Scheme". The Offer made clear the pay award and Facilitation Payment were offered in return for changes to pensions.(FTT[49])

105. We acknowledge there are other findings which could on their face be taken to paint a more ambivalent picture or which are more consistent with the payment being "from" employment:

(1) A message relayed by the unions to the employees in late July 2017, and reiterated in February 2018, included that the union wanted the deal to recognise that "pensions are deferred pay". (FTT[20])

(2) The March 2018 "joint "Company and Trade Union update" referred on the one hand to a review of arrangements but on the other hand later on in the paragraph mentions pensions, employment security and pay. (FTT [23])

106. However, the communications nearer the time of the Facilitation Payment do not pick up on the theme of pensions being viewed as deferred pay but if anything contrast it with other changes more obviously linked to pay. The fact pay and other employment related factors are mentioned separately does not detract from those bargaining chips being secured in return for the pensions changes.

107. In its finding regarding the integrated nature of the package, the FTT emphasised that the Facilitation Payment was calculated by reference to the *post* salary increase award ([85]). However this simply reflects that the Facilitation Payment was part of an integrated package (in relation to which there is no disagreement). This feature regarding how the payment was calculated did not affect what it was the Facilitation Payment was being made for, namely the adverse changes to pension rights.

108. Consistent with our conclusion in relation to the error under Ground 4, there are no findings of fact (apart from the conclusion vitiated by error of law and integrated nature of package – which are not determinative) that support that the Facilitation Payment was "from" employment. For the reasons already explained, we do not find the replacement principle of assistance on the facts of this case and do not adopt the conclusion that the better characterisation was replacement of earnings. (This conclusion was in any case not a pure finding of fact but rather a legal conclusion or a mixed question of law and fact).

109. We conclude the Facilitation Payment was not "from" employment. It was not paid from Mr Brotherhood's employment but from something else, namely compensation for the adverse changes being made to rights and expectations in relation to his pension arrangements. We therefore allow E.ON's appeal.

110. The figures in the Regulation 80 PAYE determination (£758) and s8 NICs Decision (£987.07) made in relation to Mr Brotherhood, which are the subject of the appeal were determined by HMRC on the basis the Facilitation Payment was "from employment". In accordance with our decision that that basis was incorrect, and noting no case for other figures was put in the alternative by HMRC, we determine the figures as nil.

Decision

111. E.ON's appeal is allowed. The amounts of the Regulation 80 determination and s8 Decision under appeal are determined at nil.

Signed on Original

MR JUSTICE ADAM JOHNSON

JUDGE SWAMI RAGHAVAN

UPPER TRIBUNAL JUDGES